MOTION FILED
MAR 21 1980

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-669

DAWSON CHEMICAL COMPANY, ET AL.,
Petitioners,

v.

ROHM AND HAAS COMPANY,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF FOR CHEMICAL MANUFACTURERS ASSOCIATION AS *AMICUS CURIAE*

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Pursuant to Rule 42 of the Rules of this Court, the Chemical Manufacturers Association (CMA) respectfully moves the Court for leave to file the attached brief as *amicus curiae* in the above-captioned case. Counsel for Respondent has consented to the filing of the attached brief. The consent of Petitioners was requested but refused.

The interest of CMA as *amicus curiae* is set forth more fully at pp. 1-4 of the attached brief. In summary, CMA is a voluntary, non-profit membership association of 204 chemical companies in the United States and Canada. CMA and its members believe that the patent system provides a critical incentive to innovation and research by industry and that reversal of the decision

below would impair this needed incentive in important respects.

The primary purpose of the attached brief is to discuss, more fully and from a broader perspective than the briefs for the parties and for the United States, the economic consequences of reversal of the decision below. CMA filed a similar brief in the Court of Appeals, and respectfully suggests that the attached brief will aid this Court in its consideration of the merits of this case.

Respectfully submitted,

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BRIEF FOR CHEMICAL MANUFACTURERS ASSOCIATION AS *AMICUS CURIAE*

QUESTION PRESENTED

Whether by virtue of section 271 of the Patent Act of 1952, 35 U.S.C. § 271, or otherwise, the owner of a method patent, who gives an implied license with the sale to users of a non-staple component, may decline to license others to make and sell the component, without committing patent misuse.

INTEREST OF AMICUS

The Chemical Manufacturers Association (CMA) is a voluntary non-profit membership association of 204

chemical companies in the United States and Canada representing over 90 percent of the production capacity of basic industrial chemicals within these countries. CMA has often represented the interests of its member companies in legislative, regulatory and judicial matters.

This case raises important issues concerning whether the patent laws will continue to serve as an effective incentive for research and development that results in new and valuable uses for existing chemical compounds. Patents granted for method of use inventions enjoy the same standing under the patent laws as do patents granted for inventions of machines, articles of manufacture or chemical compounds themselves. Moreover, such inventions play a particularly important role in the chemical industry: a 1975 report, for example, stated that of approximately 33,600 major new chemical developments each year, 8,400 represent new applications for existing chemicals.[1] These new applications require at least as much invention and research as do other types of inventions, and they provide benefits to the public at least as great. The science of organic chemistry has reached a state of development where skilled chemists, using advanced techniques and sophisticated equipment for synthesis, separation and analysis, can call into existence an almost limitless number of new compounds. The true value of chemical research often lies as much in the discovery of a new and valuable application for an existing compound as in the discovery of a new compound. The development of the patented Wilson method (at issue in this case) for the herbicidal use of the chemical compound, "propanil"—a method which has made possible substantial increases in rice production—provides an excellent example of the importance of such inventions.

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[1] Foster D. Snell, Inc., *Survey of the Chemical Industry 6* (June 26, 1975).

These issues are particularly significant for the chemical industry, because it has been required to allocate about 50 percent more of its net sales income to research and development than industry generally.[2] As environmental and safety requirements have multiplied, development and testing costs have increased, and the percentage of the innovative products and applications that survive the regulatory hurdles has sharply decreased. Thus, of the approximately 33,600 major new chemicals and new applications for existing chemicals developed each year, only 6,900 have been commercially successful. Of the 8,400 new applications, only 1,800 became commercially successful.[3] Companies therefore have become increasingly dependent on the profitability of the "surviving" innovations in the marketplace to recoup their massive investment in research and development and to maintain a constant level of innovation.

The Constitution authorized and Congress designed the patent system as an incentive to innovation that would give individuals and firms, for a limited period of time, the exclusive right to the value of their inventions. The patent system thereby provides a means for recouping investment in the development of new products and product applications via those that are commercially successful. As we show in Part II *infra*, it is often impracticable for the inventor of a new method of use either to practice the invention himself or to give express licenses to (and collect royalties from) users. In those situations, reversal of the decision below will make it more difficult for method patentees to recover the value of their inventions and thus to recoup the costs of research and development. Reversal would be particularly inadvisable because obligatory licensing of competitors would have costs far more serious than the costs

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[2] *Id.* at 41.

[3] *Id.* at 6.

of the exploitation method selected by the patentee here; that method, moreover, has no significant adverse competitive consequences. Because the result of reversal would be to limit the incentives provided by the patent laws for the development of new applications, without serving any good purpose, CMA submits this brief on behalf of its members.

STATEMENT

Respondent Rohm and Haas Company is the holder of a patent that describes a method of controlling weeds in rice crops. The chemical agent used in this process is "propanil," an unpatented compound for which there is no other commercial use. It was obviously impractical for Rohm and Haas to reserve the practice of this method to itself and prohibitively expensive to collect royalties from direct licenses to thousands of rice producers. Rohm and Haas concluded that the only practicable way by which it could realize the value of its invention was through the sale of propanil, which sales, of course, carry with them implied licenses [4] for its use in the patented process. Rohm and Haas did not offer separate licenses to users, and refused the request of other manufacturers of propanil for licenses which the manufacturers could then sub-license to their customers. When these manufacturers continued to sell propanil, Rohm and Haas brought suit for contributory infringement.

The district court held that Rohm and Haas' method of exploiting its patent constituted patent misuse. 191 U.S.P.Q. 691, App. 67. The Court of Appeals reversed, 599 F.2d 685, App. 139, holding that this method of exploitation is expressly sanctioned by section 271 of the Patent Act of 1952, 35 U.S.C. § 271.

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[4] As used herein, the term "implied license" refers to the authorization to use a patented process which arises by operation of law upon the patentee's sale of a component for that purpose.

SUMMARY OF ARGUMENT

We argue here that the decision of the Court of Appeals should be affirmed substantially for the reasons set forth in its thorough opinion. The express language of section 271 authorizes Rohm and Haas' conduct. The legislative history demonstrates that Congress intended in enacting that section to overrule this Court's *Mercoid* decisions,[5] which extended the doctrine of patent misuse to bar actions for contributory infringement against sellers of an unpatented component with no other use save as part of a patented combination.

This conclusion is buttressed by an examination of the alternatives available to the holder of a process patent like Rohm and Haas; that examination demonstrates that the method selected by Rohm and Haas is least costly to users and has no significant anticompetitive consequences. We further argue that, quite apart from the application of section 271, refusal by Rohm and Haas to offer separate licenses to users or to its competitors should not be held to constitute patent misuse, because that doctrine should be invoked only with respect to licensing or other practices that are contrary to the policies underlying the patent and antitrust laws, a situation not present here.

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[5] *Mercoid Corp.* v. *Mid-Continent Investment Co.*, 320 U.S. 661 (1944); *Mercoid Corp.* v. *Minneapolis-Honeywell Regulator Co.*, 320 U.S. 680 (1944).

ARGUMENT

I. THE LANGUAGE AND LEGISLATIVE HISTORY OF SECTION 271 MAKE CLEAR THAT ROHM AND HAAS' METHOD OF EXPLOITING ITS PATENT DOES NOT CONSTITUTE MISUSE.

Our purpose in this section is merely to highlight certain aspects of the language and legislative history of section 271 that are developed at greater length in the opinion of the Court of Appeals and in Respondent's brief. The careful and thoughtful opinion of the Court of Appeals held that the language of section 271, bolstered by the legislative history, sanctioned Rohm and Haas' chosen method of exploiting its method of use patent by means of implied licenses to users who purchased propanil from it. We submit that the decision below should be affirmed substantially for the reasons set forth in that opinion.

Section 271(c), which defines the cause of action for contributory infringement,[6] clearly applies to the conduct of Petitioners here, and Petitioners have so conceded (Br., p. 6). Petitioners (1) sell a "material for use in practicing a patented process"; (2) the substance is a "material part of the invention"; (3) Petitioners know that the substance is specially adapted for infringement of the patent; and (4) propanil is not a "staple article" as defined.

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[6] That section provides:

> "Whoever sells a component of a patented machine, manufacture, combination or composition, or a material or apparatus for use in practicing a patented process, constituting a material part of the invention, knowing the same to be especially made or especially adapted for use in an infringement of such patent, and not a staple article or commodity of commerce suitable for substantial noninfringing use, shall be liable as a contributory infringer."

35 U.S.C. § 271(c).

It is equally clear that Rohm and Haas has done no more than those acts permitted by the express terms of section 271(d), which limits the doctrine of patent misuse as a defense to a contributory infringement action.[7] All Rohm and Haas has done, first, is to sell a non-staple component, propanil—or "derived revenue" from these sales as a "contributory infring[er]" might do—as Rohm and Haas is permitted to do by section 271(d)(1). Second, Rohm and Haas has brought suit against petitioners for contributory infringement, as it is permitted to do by section 271(d)(3). Section 271(d)(1) and (3), taken together, authorize Rohm and Haas to act precisely as it has acted: to sell propanil itself and to sue to exclude as contributory infringers those persons, like Petitioners, who sell propanil in violation of section 271(c).

Petitioners make no attempt to explain the straightforward language of the statute, and the Government in its brief *amicus curiae* claims only that section 271(d) does not in terms address the specific facts of this case (Br., p. 13). It argues that even though section 271(d)(1) permits a process patentee to sell a non-staple component with an implied license to use it in the process, that section does not authorize such a sale as the exclusive method of exploiting such a patent. Thus, the

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[7] It provides:

> "No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following: (1) derived revenue from acts which if performed by another without his consent would constitute contributory infringement of the patent; (2) licensed or authorized another to perform acts which if performed without his consent would constitute contributory infringement of the patent; (3) sought to enforce his patent rights against infringement or contributory infringement."

35 U.S.C. § 271(d).

argument runs, to avoid misuse the patentee must also offer separate licenses either to users or to competing manufacturers. The Government, however, cites no language in section 271 that supports its argument that a patentee, in order to avoid misuse by reason of section 271(d), must first take some other action, like the offering of separate licenses.

Indeed, section 271(d), which, as we show below, was enacted in response to the decisions in the *Mercoid* cases,[8] would have little meaning unless it were read to legitimize sales of a non-staple by a process patentee as the exclusive means of exploiting his patent. Read as the Government would have it, section 271(d)(1) does nothing more than authorize a process patentee to sell a component. While *Mercoid* had precluded such sales as the *exclusive* way of exploiting a process patent, nothing in *Mercoid* or in any other case had ever suggested that a use patentee could not sell a component used in the patented process, as one of many sellers. Thus, even after *Mercoid*, no statute was necessary to give a patentee this right.[9]

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[8] *Mercoid Corp.* v. *Mid-Continent Investment Co.*, 320 U.S. 661 (1944); *Mercoid Corp.* v. *Minneapolis-Honeywell Regulator Co.*, 320 U.S. 680 (1944).

[9] Giles S. Rich, the principal draftsman of section 271, advised the House Committee that subsection (d)(1) was intended to overrule *Barber Asphalt Corp.* v. *La Fera Grecco Contracting Co.*, 116 F.2d 211 (3d Cir. 1940), at least insofar as the rule in that case might have been applied to non-staples. *See Patent Law Codification and Revision: Hearings on H.R. 3760 Before Subcomm. No. 3 of the House Comm. on the Judiciary*, 82d Cong., 1st Sess. 174, 207 (1951) (*"1951 Hearings"*) In *Barber*, the Court of Appeals found misuse where the patentee licensed users but had manipulated its royalty rates by price discrimination in favor of those who also purchased the unpatented goods from it. This is no less calculated to "extend" the patent monopoly than is the express or implied conditioning of a license on the purchase of an unpatented commodity. *See* Baxter, *Legal Restrictions on Exploitation of the Patent Monopoly: An Economic Analysis*, 76 Yale L.J. 267, 318 (1966). If section 271(d)(1) was intended to permit a patent-holder to exclude competing sellers of non-staples by charging discriminatory royalties to licensees who purchase non-staple articles from it—thereby effectively preventing other sellers from competing with it—there is no reason, as a matter of economic analysis, why the statute should not be construed to permit it to exclude competing sellers by refusing licenses.

The legislative history of section 271 supports this natural reading of the statute. Prior to the *Mercoid* cases, this Court had never held that the doctrine of patent misuse provided a defense to an action for contributory infringement where the patentee had conditioned the licensing of its patent on the purchase from it of an unpatented non-staple component.[10] *Compare Leeds & Catlin Corp* v. *Victor Talking Machine Co.*, 213 U.S. 325 (1909) (recovery for contributory infringement allowed where component was non-staple) *with Carbice Corp* v. *American Patent Development Corp.*, 283 U.S. 27 (1931) (patent misuse found where component was staple). The decisions in the *Mercoid* cases, which involved stoker switches used in a combination patent for a heating system, appeared expressly to overrule the *Leeds & Catlin* case. *See Mercoid Corp.* v. *Mid-Continent Investment Co.*, 320 U.S. at 668. The Court assumed that the stoker switches had no commercial use except in the combination. Nevertheless, the Court found patent misuse by the patentee and its exclusive licensee in refusing to license the combination unless the stoker switches were purchased from them. Furthermore, Mr. Justice Douglas intimated that *Mercoid* may have eliminated the contributory infringement doctrine altogether. *Id.* at 669 (dictum).

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[10] *B. B. Chemical Co.* v. *Ellis*, 314 U.S. 495 (1942), did not involve a non-staple. As the Court of Appeals noted, 599 F.2d at 695, App. 157, this Court in *B. B. Chemical* did not address the question of the character of the component sold. While the Court of Appeals in that case evidently assumed the component was a non-staple, the district court in *B. B. Chemical* clearly found that the product was a staple. *See B. B. Chemical Co.* v. *Ellis*, 32 F. Supp. 690, 698 (D. Mass. 1940).

Congress in enacting section 271 intended to reinstate the doctrine of contributory infringement as it existed before *Mercoid*.[11] Giles S. Rich, the principal draftsman of the provisions that became section 271 [12] and now an Associate Judge of the Court of Customs and Patent Appeals, testified extensively on the purpose of the provisions. He more than once indicated that "[t]he exception which we wish to make to the misuse doctrine *would reverse the result in the Mercoid case*" and would revitalize *Leeds & Catlin*. *Contributory Infringement: Hearings on H.R. 3866 Before Subcomm. No. 4 of the House*

[11] This Court has stated that section 271 overruled *Mercoid*. In *Aro Manufacturing Co.* v. *Convertible Top Replacement Co.*, 377 U.S. 476 (1964) (*Aro II*), it concluded that

> "Congress enacted § 271 for the express purpose of reinstating the doctrine of contributory infringement as it had been developed by decisions prior to Mercoid. . . ." 377 U.S. at 492.

Moreover, the opinion for the Court in *Aro II* cited with approval both the dissenting opinion of Mr. Justice Harlan (joined by Justices Frankfurter and Stewart) and the concurring opinion of Mr. Justice Brennan in *Aro Manufacturing Co.* v. *Convertible Top Replacement Co.*, 365 U.S. 336 (1961) (*Aro I*). For Mr. Justice Harlan, the statutory purpose was readily discernible:

> "It seems clear from the legislative history of the 1952 Act that Congress intended (1) to reaffirm the doctrine of contributory infringement . . . in cases like *Leeds & Catlin*, [and] (2) to give that doctrine precedence against a claim of patent misuse as conceived in the *Mercoid* cases, at least where the misuse is said to inhere simply in assertion of patent rights." 365 U.S. at 378 n.6.

Similarly, in his concurrence, Mr. Justice Brennan left no doubt that, given section 271, the principles of *Leeds & Catlin* survived *Mercoid*. *See id.* at 365-67 & nn. 4-10.

[12] Section 271 was an outgrowth of bills, first introduced in 1948 and again in 1949, that were directed solely to the question of contributory infringement. H.R. 5988, 80th Cong., 2d Sess. (1948); H.R. 3866, 81st Cong., 1st Sess. (1949). The bill that became the Patent Act of 1952 incorporated essentially the same provisions, though in different language, into a general codification of the patent laws. *See generally* Federico, *Commentary on the New Patent Act*, 35 U.S.C.A., at 6-8 (West 1954).

Comm. on the Judiciary, 81st Cong., 1st Sess. 67, 68-69 (1949) ("*1949 Hearings*") (emphasis added).[13] The Justice Department, opposing the legislation, also recognized the purpose of the bill. Wilbur L. Fugate, testifying in 1951 on behalf of the Antitrust Division, told the Committee that section 271(d) "would have the effect of wiping out a good deal of the law relating to misuse of patents, particularly with reference to tying-in clauses." [14] *1951 Hearings* 165.

The congressmen present at the 1951 hearings on the proposed patent legislation understood that section 271 did more than merely codify the case law on contributory infringement. Congressman Rogers, for example, stated his understanding that the purpose of the Act was to "reinstate" the doctrine of contributory infringement. *1951 Hearings* 159. And, at another point, he expressed his view that the proponents of the bill were asking Congress to "reestablish what you thought you had before the *Mercoid* case." *1951 Hearings* 173.

Judge Rich repeatedly emphasized the important distinction between staples and non-staples in the application of the misuse doctrine. He explained that, while

[13] *See also 1951 Hearings* 161; *Contributory Infringement in Patents: Hearings on H.R. 5988 Before the Subcomm. on Patents, Trade-Marks and Copyrights of the House Comm. on the Judiciary*, 80th Cong., 2d Sess. 4-5 (1948) ("*1948 Hearings*"). Petitioners imply (Br., p. 20) that there is nothing to suggest Congress was aware of Judge Rich's earlier testimony. However, Judge Rich in his 1951 testimony expressly referred to his earlier testimony. *1951 Hearings* 150-51, 161.

[14] *See also 1949 Hearings* 52 (remarks of John C. Stedman); *1951 Hearings* 97 (Statement of T. Hayward Brown). While the statements of opponents of legislation may not always be authoritative, they are entitled to weight, particularly when, as is the case here, both proponents and opponents agree about the effect of proposed legislation. *First Nat'l Bank* v. *Walker Bank & Trust Co.*, 385 U.S. 252, 261 (1967); *Arizona* v. *California*, 373 U.S. 546, 582-83 n.85 (1963).

exclusive sales of an unpatented *staple* component by a patent-holder would permit a court to find misuse, the same would not be true as to non-staples under section 271(d) as proposed:

> "MR. WILLIS: All right, what would the bill do to the misuse doctrine? Would it preserve it and to what extent.
>
> "MR. RICH: It would preserve it in such cases as the Carbice case . . . , where the things dealt with are staple commodities of commerce and not especially for use in infringement of patents. . . . The only change made by the decision in the Mercoid case was to extend the misuse doctrine so as to apply to . . . elements having no other use than in an infringement." *1949 Hearings* 68.[15]

The Committee reports corroborate Judge Rich's view of the purpose of the statute. The view of the Petitioners (Br., pp. 19, 22) and the Government (Br., pp. 16-17) that these reports show only that Congress intended to codify the law as it existed after *Mercoid*, is simply not correct. The House Committee stated that while the primary purpose of the Act as a whole was codification, "there are a number of changes in substantive statutory law." Among the "major changes or innovations" was

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[15] *See also 1951 Hearings* 166-67; *1948 Hearings* 17-18 (1948) (letter from Theodore Kenyon, patent attorney).

Petitioners distort Judge Rich's testimony. They claim (Br., p. 21) that Rich agreed with Congressman Crumpacker that section 271(d) would not prevent a holding of misuse where a patentee was "trying to gain a limited monopoly of unpatented articles." *1951 Hearings* 173-74. The hearings indicate that Judge Rich had in mind only monopolization of staples when he answered Congressman Crumpacker's question. Before responding, Judge Rich qualified the question, asking "If we assume that staples are excluded from paragraph (c)?" *1951 Hearings* 173. Only then did Judge Rich assent. He evidently contemplated that paragraph (d) permitted a finding of misuse only where the unpatented product sold was a staple.

incorporation of the "judicial doctrine of contributory infringement." H.R. Rep. No. 1923, 82d Cong., 1st Sess. 5 (1952).

Both Reports indicate that the clear purpose was to revitalize the doctrine of contributory infringement, which "has been part of our laws for about 80 years." *Id.* at 9; S. Rep. No. 1979, 82d Cong., 2d Sess. 8 (1952). Congress intended to eliminate the "[c]onsiderable doubt and confusion as to the scope of contributory infringement [that] has resulted from a number of decisions of the courts in recent years." H.R. Rep. No. 1923, at 9; S. Rep. No. 1979, at 8. Further, the Reports stressed, as Judge Rich did, that only non-staples are included in the definition of contributory infringement. Finally, the Reports' discussion of section 271(d) emphasized that the section "provides that one who *merely does what he is authorized to do by statute* is not guilty of misuse of the patent." H.R. Rep. No. 1923, at 9; S. Rep. No. 1979, at 8 (emphasis supplied).[16]

In sum, a proper reading of section 271 and its legislative history demonstrates that Congress intended to authorize Rohm and Haas' conduct in this case.

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[16] The cursory debate on the floor of the Senate, on which Petitioners (Br., pp. 19-20) and the Government (Br., p. 17) place principal reliance, should not outweigh the considered and lengthy explanation of the legislation's purpose by its principal author. *See, e.g., Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 202-03 (1976); *United States* v. *Enmons*, 410 U.S. 396, 405 n.14 (1973); 2A D. Sands, *Sutherland Statutory Construction* 214 (4th ed. 1973). As the Court of Appeals properly recognized, 599 F.2d at 698, App. 165, only moments after telling Senator Saltonstall that the bill "codified" the patent laws, Senator McCarran inserted in the record a prepared statement that obviously refers to section 271:

> "In view of decisions of the Supreme Court and others as well as trial by practice and error *there have been some changes in the law of patents as it now exists. . . .*" 98 Cong. Rec. 9323 (1952) (emphasis added).

II. AFFIRMANCE IS APPROPRIATE BECAUSE THE ECONOMIC CONSEQUENCES OF APPLYING THE MISUSE DOCTRINE IN CASES OF THIS KIND WOULD BE SIGNIFICANTLY ADVERSE.

The conclusion that section 271(d) permits "use" patentees to collect royalties as Rohm and Haas has done is reinforced by the fact that foreclosing that option would have significant adverse consequences not only for patentees but for users and the economy generally. Unlike *Deepsouth Packing*,[17] therefore, the result reached below is supported by much more than "mere inference from ambiguous statutory language"; and "a clear and certain signal from Congress"—though we believe one has been given—is not required. For the same reason, patent misuse doctrine should not be applied even if section 271—which merely states what is *not* misuse—were thought to leave the question open. Thus the Government's contention (Br., p. 10 n. 11) that practical considerations favoring Rohm and Haas' method of exploiting its patent "conceivably could persuade Congress to change the legal principle governing this case" is wide of the mark. Such considerations can and should be taken into account in deciding whether the misuse doctrine should be applied.

As the briefs of the Government (Br., pp. 9-10) and the Petitioners (Br., pp. 34-35) recognize, the appropriateness of applying the misuse doctrine to this kind of case requires considering the effect on the pro-innovation policy of the patent law and on the policies served by the antitrust laws, which also seek to foster an innovative and efficient economy and are therefore largely complementary. Neither brief, however, closely examines whether the public interest reflected in those policies would in fact be served by finding misuse here. Neither

[17] *Deepsouth Packing Co.* v. *Laitram Corp.*, 406 U.S. 518, 531 (1972).

brief adequately explores the practical economic consequences of preventing a holder of this kind of "use" patent from seeking to recover the value of his invention by granting licenses via the sale of a non-staple component, and thus remitting him to alternative methods of attempting to recover what the patent law entitles him to.

A careful examination of those alternatives and their consequences show a clear balance in favor of permitting Rohm and Haas to do what it has done. As compared to its alternatives, that method has obvious and substantial advantages in the form of lower costs to patentees and to users of the patented process—a result that serves rather than disserves the purposes of the antitrust laws. And in so enhancing the ability of "use" patentees to recover the value of their economic contributions, permitting that method strengthens the incentives to "use" innovations—the goal of the patent laws. In contrast, the "anticompetitive" effects, if any, are minimal.

A. Compared to Alternatives, Rohm and Haas' Method of Exploiting its Patent Has Significant Economic Advantages.

The economic gains in the method of exploiting a patent chosen by Rohm and Haas become clear when the method is compared to the other options realistically available to the holder of a "use" patent of the kind involved here. We take it as given that a patentee is normally entitled to recover the full economic value of his patent, as determined in the market place. Further, the mere fact that a method of licensing facilitates the patentee's ability to recover that reward is not a basis for condemnation. It is true, of course, that a patent licensing arrangement is not automatically vindicated simply because it assists a patentee in recovering his full reward. That consideration remains highly relevant, however. Before a particular arrangement is con-

demned, it must be asked whether alternative methods would in fact be economically preferable. That is not the case here.

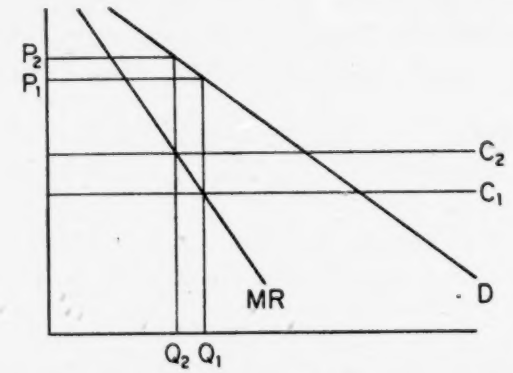
1. *Granting a license to users with purchase of an unpatented component from the patentees (as done in this case).* Of the alternative methods of attempting to obtain what a patent is worth, this method is plainly the most efficient. A reward to the invention proportional to use is automatically collected from the user with the sale of the component. There are no transactions costs imposed on either side. The user does not have to keep records of use or make periodic royalty payments. The patentee incurs no cost in auditing users to determine whether they have paid what is due. Users, patentees, and the courts are relieved of the burdens of royalty litigation. Moreover, the patentee can readily vary the royalty rate to reflect any increased value of the patent simply by raising the component price. No other option is as efficient—for patentees, for users, or for society generally—as we shall now show; because they all yield rewards lower than the economic value of the patented invention, none would provide as great an incentive to discover new and useful processes, as the Government concedes (Br., p. 10 n.11).

2. *Self-exploitation.* A process patentee, like any patentee, is clearly entitled to keep practice of the patent to himself. Unlike the case of a product patent or a manufacturing process patent, however, self-practice of a "use" patent like that involved here—requiring "on site" application at a multitude of locations—is not likely to be feasible or efficient. And even if it were, the competitive consequences would be worse than with the alternative followed by Rohm and Haas. Self-exploitation would not only create the same "monopoly" in a single non-staple component that the challenged practice creates, but would also "monopolize" or "tend to monop-

olize" any other components and the business of practicing the process as well.

3. *Licensing users without production and sale of components.* If this alternative were utilized, both the patentee and the users would incur substantial transactions costs of the kind we have just described. These additional costs would lead to a higher effective royalty price to users and lower utilization of the patented process—a clear social loss; with higher costs and more restricted use, net royalty revenues to the patentee would be less than would otherwise be the case.[18] Indeed, the costs to the patentee of insuring the collection of royalties due from hundreds or thousands of users, and of suing those who have not properly paid, may be so disproportionately high as to render this alternative wholly infeasible—the same reason that led courts to recognize,

[18] These points can be illustrated by the following simple diagram:



C_1 is the cost of producing and selling the component with an implied license to practice the patent; C_2 the higher cost of the component plus the transactions costs of separate direct licenses. D is the demand curve for components plus the right to use the process; and MR is the marginal revenue curve, indicating the increased *net* revenue from expanded sales. At the lower cost (C_1) the patentee would maximize profits at an aggregate price of P_1 and sales of Q_1. At the higher cost (C_2) he would maximize at a higher price (P_2) and lower sales (Q_2). Not only would users suffer, but the patentee's net profits—shown by the P_2 rectangle above C_2—would be lower than at the lower C_1 cost.

and Congress to codify, a cause of action for contributory infringement.[19]

4. *Options to users to purchase an express license alone or an implied license with the purchase of a non-staple component.* Although Petitioners seek a license from Rohm and Haas, they agree that licenses to competing component producers are not necessary to avoid a charge of misuse (Br., pp. 30-31). A process patentee is clearly entitled to offer would-be users two alternatives: a license at a specified royalty, or an implied license with the purchase of a non-staple component from the patentee at a specified price. In so doing, the patentee is entitled to specify a lower price for the "package" than for a license and the component purchased separately, where the reduction simply reflects the lower transactions costs of collecting the royalty through the sale of the component.[20] Moreover, the effective cost of the license alone would be higher if the royalty rates were the same, because of the subsequent transactions costs to the user—record keeping, making payments, and litigation disputes over

[19] *See, e.g., Westinghouse Electric & Manufacturing Co.* v. *Precise Manufacturing Corp.*, 11 F.2d 209 (2d Cir. 1926); *1951 Hearings* 160.

[20] Neither Clayton Act § 3, 15 U.S.C. § 14, nor Sherman Act § 1, 15 U.S.C. § 1, could reasonably be interpreted to prohibit such a cost-justified lower price for the package. It is accepted that "where the buyer is free to take either product by itself there is no tying problem even though the seller may also offer the two items as a unit at a single price." *Northern Pacific Ry.* v. *United States*, 356 U.S. 1, 6 n.4 (1958). Courts have found violations of the antitrust laws where, because of rebates or other pricing arrangements, the purchaser, as a practical matter, will always take the package. *See, e.g., SmithKline Corp.* v. *Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir.), *cert. denied*, 439 U.S. 838 (1978); *Advance Business Systems & Supply Co.* v. *SCM Corp.*, 415 F.2d 55 (4th Cir. 1969), *cert. denied*, 397 U.S. 920 (1970). However, nothing in these cases suggests that cost-justified differential pricing of the separate components and the package would be a violation of the antitrust laws. To rule otherwise would be to deprive customers of the resulting efficiencies.

amounts due. Accordingly, users would obviously elect to buy the "package" unless competing component producers charged a component price sufficiently lower than the patentee's to offset the higher effective royalty on the direct license alone. Absent that circumstance, this alternative would produce the same result as "package" selling only. It is, of course, possible that competing component producers would be so much more efficient that they could "undersell" the patentee. But this is unlikely, given the relatively high transactions costs to the patentee and to users under direct licenses.[21]

In any event, this alternative would be a fertile source of expensive and involved litigation by competing component producers claiming that the patentee's lower "package" price was not cost justified.[22] And, as experience under the Robinson-Patman Act, 15 U.S.C. § 13, has shown, that issue can be a morass.[23] The problems are particularly severe in dealing with transactions costs of the kind we have described, which typically can be only roughly estimated.

5. *Licensing competing component producers with the right to sublicense use of the patent.* While this alternative was described by the court below as an "attractive" possibility, 599 F.2d at 702 n.27, App. 177 n.27, it is not as attractive as it may look. It would in-

[21] Moreover as we note below, p. 24 *infra*, the patentee in that event would find it more profitable to cease production of the component, and license competitors to sell their product to users with an implied license to practice the patent.

[22] Competitors would also be likely to claim that either the express royalty is excessively high, or the patentee is selling the component "below cost." The latter claim would raise the difficulties described at pp. 20-21 *infra*.

[23] "Proof of a cost justification being what it is, too often no one can ascertain whether a price is cost justified." *Automatic Canteen Co.* v. *FTC*, 346 U.S. 61, 79 (1953).

deed involve lower transactions costs than direct licenses to a multitude of users, although of course there would be at least some such costs that are not incurred by the method Rohm and Haas uses here. There are, however, other significant disadvantages.

First, the patentee, as a practical matter, would rarely be able to obtain royalties comparable to the value of the invention. To avoid a charge of misuse, the patentee would have to grant licenses and set the royalty rate before beginning to sell the component, when commonly the prospective value of the invention is uncertain and potential licensees will insist on a conservative figure that is likely to be below true value.[24] Moreover, the patentee runs the risk that should he in good faith insist on a higher figure than licensees would accept, he would be faced in any infringement suit against them with a charge of patent misuse for "in effect" having refused to license others and thus "monopolized" the component.

Second, particularly in the case of a non-staple component for which there is no independent market price, it would be extraordinarily difficult to determine whether or not the royalty rate was "unreasonably high," either at the time of license negotiation or at some later time, when licensees claim that they cannot pay the royalty and still profitably sell at the package price charged by the patentee. The claim would be that if a "reasonable price" for the component were deducted from the patentee's package price, the resulting imputed royalty rate would be below the express rate offered competing component producers—*i.e.*, that the competitors were being discriminated against. That claim of discriminatory royalty rates would force the courts to determine the

[24] Even if the original royalty were to approximate the value of the invention, the patentee as a practical matter would be unable to change the rate later should the market value of the invention increase. Licensees will rarely if ever accept a license giving the licensor the right to revise the royalty rate upward.

patentee's "costs" of producing the component.[25] As in cases charging "predatory pricing," resolving that issue would by no means be simple,[26] particularly where there are joint costs in the production of the component and similiar items.[27]

Third, and finally, this alternative would raise another difficult question for both patentees and for courts—how many competing producers must a patentee license in order to avoid a charge of misuse?[28] Almost by defini-

[25] This problem was detected by Judge Magruder, concurring in *B. B. Chemical Co.* v. *Ellis*, 117 F.2d 829, 839 (1st Cir. 1941), *aff'd*, 314 U.S. 495 (1942). "If it were sought to extend the doctrine of *Leiich* [*Manufacturing Co.* v. *Barber Co.*, 302 U.S. 458 (1938) and *Carbice Corp.* v. *American Patent Development Corp.*, 283 U.S. 27 (1931),] to cover such a situation, many difficulties would at once be presented, not the least of which would be the elusive problems of cost accounting."

[26] While differing in their assessment of the difficulties, protagonists of various tests for "predatory pricing" are agreed on this point. See, *e.g.*, Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 Yale L.J. 284, 305 (1977); Areeda & Turner, *Williamson on Predatory Pricing*, 87 Yale L.J. 1337, 1346, 1351-52 (1978).

[27] The problem described in text would be moderated, though not eliminated, where the component is a staple commodity, and the patentee sells the component separately for other uses. *Cf. Ansul Co.* v. *Uniroyal, Inc.*, 306 F. Supp. 541, 562-63 (S.D.N.Y. 1969), *aff'd in part*, 448 F.2d 872 (2d Cir. 1971), *cert. denied*, 404 U.S. 1018 (1972). Then, at least, the implicit royalty charged by the patentee could be readily determined by subtracting his price of the component alone from the price for the component with an implied license, and if that figure were substantially less than the rate charged competing component producers, illicit "exclusion" would be at least presumptively established. (On the other hand, cost analysis would be required where it appeared that the patentee may simply have made a few low-priced sales of the component in an effort to establish that his implied license royalty was the same as the direct license royalty.) The staple case is academic under current misuse and contributory infringement doctrines, however, as competing producers of a staple cannot be sued for contributory infringement and hence have no reason to seek a license. *See* 35 U.S.C. § 271(c).

[28] As the Government notes (Br., p. 5 n.7), the District Court reserved for later proceedings the number of license offers to other propanil producers necessary to dissipate the misuse.

commodity that has had no known use. The patentee may be the only party willing to invest in production facilities at the outset, or no potential independent producer may be willing to make the investment unless granted exclusive production rights.[29] Yet a requirement that the patentee license all additional comers, or even any more comers, may create wasteful excess capacity or inefficient production scale and destroy the investment of the party or parties who took the initial risks. At best, a sensible rule that took all those factors into account would leave considerable undertainty and promote litigation involving very complex questions of fact.

* * * *

In sum, denying process patentees like Rohm and Haas the right to collect royalties in the way that Rohm and Haas does would force them to employ options considerably more costly and burdensome to them, to those who wish to use the patented process, and to the economy in general.[30] And given the infeasibility of a patentee reserving to himself the business of practicing process patents of this kind, denying this option would be likely to reduce significantly the incentives to invent uses for compounds having no known use.

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[29] An exclusive license with the right to sublicense use of the patent would be at best indistinguishable from the case in which the patentee reserves that right to himself. Indeed, it would be worse unless the patentee could impose a maximum price. Otherwise, the exclusive licensee would price to obtain monopoly profits on the component; the price to users would be higher than if the patentee were selling the package; and both the patentee and users would suffer. *Cf.* P. Areeda, *Antitrust Analysis* 500 n.4 (1974).

[30] Compare this Court's response to the claim that promotional activities encouraged by vertical restrictions on dealers decrease interbrand competition by enhancing product differentiation: "Nor is it clear that a *per se* rule would result in anything more than a shift to less efficient methods of obtaining the same promotional effect." *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36, 56 n.25 (1977).

B. The Potential Adverse Effects of the Practice are Minimal.

While there may be circumstances in which strong countervailing considerations require that the costs discussed above must be accepted, there are no such countervailing effects here. Indeed, the Government Brief cites only one possible adverse effect from a patentee reserving component sales to itself, namely less efficient production of that component. As we shall shortly explain, that danger is minimal.

No other adverse effect can reasonably be claimed. Unlike price-fixing clauses or similar restrictions in patent licenses to horizontal competitors, which may well enable a patentee to reap monopoly profits unrelated to his patent,[31] Rohm and Haas' system of reserving component sales to itself does not allow it to recover more than the value of its invention, or obtain a "second monopoly profit" on the sale of the component.[32]

For a method patent whose practice requires an unpatented component, the value of the invention is measured by the difference between the cost of the component alone and the profit-maximizing price that buyers will pay for both the component and the right to use it in the patented method at a given volume. There is only a single "monopoly profit" that can be obtained from the joint sale of the component and the right to use the patented method; for any given level of demand, that profit is maximized at a particular aggregate price for the two. Whether the patentee-manufacturer can feasibly recover the value of the patent by direct licensing

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[31] *See, e.g.*, Baxter, *Legal Restrictions on Exploitation of the Patent Monopoly: An Economic Analysis*, 76 Yale L.J. 267, 335-337 (1966).

[32] *See* W. Bowman, *Patent and Antitrust Law: A Legal and Economic Appraisal* 54-55 (1973).

or, as here, by component sales with licenses, it cannot obtain additional profits by excluding others from manufacturing the component. If, for example, the patentee were to raise the price of the component above a competitive level, net profits would be reduced unless the patentee also lowered the price for using the patent method by a corresponding amount.[33]

It is possible, as the Government (Br., pp. 10-11) points out, that exclusivity in the production of a non-staple component may, for its duration, lower the likelihood that more efficient methods of producing that component will be developed. But this effect, if any, is likely to be insubstantial. First, the patentee, like any other producer, has a strong incentive to cut production costs, because lower costs will increase his profits from the licensing of the patented process.[34] Second, for the same reason, the patentee has an incentive to utilize any more efficient methods of production developed by others, or to cease his own production and buy the component from others who could produce more cheaply. Third, for these reasons, a substantial adverse effect is particularly un-

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[33] Assume, for example, that users are willing to pay $1 per unit of propanil to practice the Wilson method at a volume of use which maximizes net aggregate revenues for the manufacturer-patentee. Assume further that the cost of producing propanil in this volume (including reasonable return on investment) is $.60 per unit. Since $.60 would thus be the competitive price of propanil, users would be willing to pay a royalty of $.40 to use the method—the value of the invention. In these circumstances, Rohm and Haas cannot sell its propanil for more than $.60 without reducing its royalty below $.40, the fair value of the invention. *Cf.* R. Posner, *Antitrust Law* 173 (1976).

[34] In the hypothetical example in note 33 *supra*, if demand is at all elastic, the profit maximizing price will drop below $1.00 and the volume of sales will increase. If the new cost of propanil were $.50 and new profit maximizing price were $.95 the patentee would be able to increase his royalty to $.45, or, even if such increase were not feasible, to enjoy a greater return on the additional sales at the new lower price.

likely where the non-staple component is a simple part or chemical mix that the patentee produces interchangeably with similar products in which he faces competition. In such cases, competitive pressures to produce those other products efficiently will affect production of the non-staple as well. Finally, it is unlikely that a non-staple will remain a non-staple for long. New uses are likely to be developed by other users or by would-be producers who would then be free to produce, without threat of contributory infringement, once a new use is found.[35]

In short, the sole possible benefit from holding Rohm and Haas' practice to be patent misuse is greatly outweighed—from both patent *and* antitrust law perspectives—by the substantial economic costs of depriving use patentees of that option. Thus affirmance is appropriate whether or not dictated by section 271 of the Patent Code.

C. Affirmance Here Need Not Be Deterred by the Implications of Such a Holding for Patent Misuse and Antitrust Rules in Other Cases.

The question may be raised whether affirmance of the decision below may not imply broader revision of the patent misuse doctrine and of antitrust rules dealing with "tying" arrangements. It need not. If affirmance is rested solely on the ground that Congress in enacting sections 271(c) and (d) intended to preclude a finding of misuse when a patentee grants licenses only in connection with the sale of a non-staple component, all such issues would be left to another day.

However, we would be less than candid if we did not agree that much of the above analysis is relevant as well to the sale of a staple component with an implied license.

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[35] Indeed, the Government concedes as much (Br., p. 10 n.11).

Similarly, since patent misuse and antitrust doctrines in this area are closely allied, the analysis as applied to patent misuse also bears on the proper antitrust treatment of such arrangements. And indeed, there is much to be said for the proposition that a reevaluation of patent misuse and antitrust doctrines in this area is in order.

This Court has never reconsidered—as it did in *GTE Sylvania*[36] with respect to vertical restrictions on dealers—whether the necessary economic predicates for *per se* or virtual *per se* rules are indeed present with respect to tying arrangements. Yet much as in *GTE Sylvania*, economic analysis (as our discussion in Part II A, *supra*, illustrates) has simply refuted the root assumption—uncritically cited by Petitioners here (Br., pp. 31-32)—that "[t]ying agreements serve hardly any purpose beyond the suppression of competition."[37]

Reexamination seems particularly appropriate for the patent misuse doctrine, which from its inception and as extended is a strict *per se* rule. With the *Mercoid* cases, "tying" a license of a combination or process patent to the sale of a component—staple or non-staple—constituted misuse without more. In contrast to the inquiries typical of a *GTE Sylvania* rule of reason approach, misuse cases treat as irrelevant the purpose or effect of the practice, and the consequences of alternative methods of patent exploitation.[38] Given the analysis set forth above, it does seem appropriate that the *per se* patent misuse doctrine be reconsidered even with respect to staple commodities.

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[36] *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

[37] *United States* v. *Loew's, Inc.*, 371 U.S. 38, 44 (1962), *citing Standard Oil Co.* v. *United States*, 337 U.S. 293, 305-06 (1949).

[38] *See, e.g., B. B. Chemical Co.* v. *Ellis*, 314 U.S. 495, 498 (1942).

Nor is there anything to preclude the Court from reevaluating its position on patent misuse as applied to staples or non-staples. Patent misuse is a judicially created doctrine that can be judicially revised. Whatever else it means, section 271(d) of the Patent Code merely states what is *not* patent misuse, not what is. It is thus no bar to judicial contraction of that doctrine.[39]

Moreover, a finding of no misuse on the present facts would not necessarily determine the question of whether limiting licenses to purchasers of a staple component should or should not be patent misuse. Exclusive sales of staples may differ, in terms of economic consequences, from exclusive sales of non-staples. For example, there may well be less need for incentives to find new uses for staples than to find uses for products having no known use. Producers of staple commodities have strong incentives to find new uses for their products; and new uses for a product already produced and widely sold are likely to be developed by outside potential users experimenting in the normal course.

Finally, while the above analysis suggests that the prevailing antitrust law on tying arrangements is unduly harsh, those rules are not strict *per se* rules and the kinds of considerations recognized in such cases as

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[39] Nor does section 271(c), in foreclosing contributory infringement actions against producers of staple commodities, stand in the way of revising that aspect of patent misuse law. Prohibiting suit for contributory infringement against producers of staple commodities is justified, independently of misuse considerations, as a means of relieving such producers from the burdensome obligation of determining the use to which their customers will put the product. *See 1951 Hearings* 159-61. Limiting patent misuse thus would not restore contributory infringement rights against producers of staple products. A patentee would, of course, continue to have a right of action for active inducement of infringement, even against producers of staples. 35 U.S.C. § 271(b).

Jerrold Electronics[40] can be expanded or not when antitrust claims raising them later appear.

CONCLUSION

For the reasons set forth above, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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March 21, 1980

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[40] *United States* v. *Jerrold Electronics Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961). *See also FTC* v. *Sinclair Refining Co.*, 261 U.S. 463 (1923); *Dehydrating Process Co.* v. *A. O. Smith Corp.*, 292 F.2d 653 (1st Cir.), *cert. denied*, 368 U.S. 931 (1961).